Columbia Law Review.

Published monthly during the Academic Year by Columbia Law Students.

SUBSCRIPTION PRICE, $2.50 PER ANNUM. 35 CENTS PER NUMBER.

NOTES.

RIGHT TO STOCK DIVIDENDS AS BETWEEN LIFE TENANT AND REMAINDERMAN.—In cases where the "dividends," "income" or "profits" from shares of stock are bequeathed or granted in trust for a beneficiary for life, the capital of the trust being reserved for the remainderman, the question as to whether stock dividends should form a part of the income and go to the life tenant, or form a part of the corpus of the estate and go to the remainderman, is one upon which the authorities differ widely. It is said that there are three general doctrines existing in the courts to-day, Cook, Stock and Stockholders §§ 554, 555, 556; 26 Am. Law Rev. 1; Cf. 2 Perry, Trusts, 5th ed., § 545; Clark, Corporations §§ 354–358; 1 Morawetz, Corporations §§ 468–471; namely, (1) the "Pennsylvania" rule that all stock dividends which represent profits of the corporation earned during the time in which the life tenant is entitled to the income go to the life tenant as income, without regard to the form of the transaction in which they are distributed, and only those shares representing enhancement of the capital go to the remainderman, citing *Earp's Appeal* (1857) 28 Pa. St. 368 as the leading case; (2) the "Massachusetts" rule that all cash dividends however large are income and all stock dividends however made are capital, citing *Minot* v. *Paine* (1868) 99 Mass. 101 as the leading case; and (3) the "English" rule that all regular and ordinary dividends, whether cash or stock, go to the life tenant and extraordinary dividends, cash or stock, go to the remainderman, citing *Brander* v. *Brander* (1799) 4 Ves. Jr. 800; *Paris* v. *Paris* (1804) 10 Ves. Jr. 185; *Wilts* v. *Steere* (1807) 13 Ves. Jr. 363; *Irving* v. *Houston* (1803) 4 Paton Sc. App. 521, as leading cases. An examination of the earlier English and Massachusetts cases, however,

indicates that no such arbitrary rules were ever intended to be laid down, the fundamental inquiry in those cases, as in the Pennsylvania cases, having been to determine whether the stock dividends represented income or capital, see *Barclay* v. *Wainewright* (1807) 14 Ves. Jr. 66; *Bouche* v. *Sproule* (1887) L. R. 12 App. Cas. 385; *Leland* v. *Hayden* (1869) 102 Mass. 542, and the English and Massachusetts courts of to-day have reached substantial accord in laying down the rule that stock dividends representing the natural growth of the capital go to the remainderman, and that stock dividends representing profits of the corporation must be capital or income according as the earnings which they represent have been treated by the corporation, in the valid exercise of its authority, as a part of the capital or permanent assets of the corporation, or not. *In re Barton's Trust* (1867) L. R. 5 Eq. 238; *Bouche* v. *Sproule* (1887) L. R. 12 App. Cas. 385; *Leland* v. *Hayden* (1869) 102 Mass. 542; *Rand* v. *Hubbell* (1874) 115 Mass. 461; *Gibbons* v. *Mahon* (1890) 136 U. S. 549. All jurisdictions, therefore, agree as to the disposition of stock dividends representing the natural growth and enhancement of the capital, and the chief point of conflict in the cases is as to what rule should govern the disposition of stock dividends representing the earnings of the corporation. It is, of course, desirable that the intention of the testator shall be carried out, but since this can be ascertained, in the absence of other evidence, only by the terms used, the fundamental question is whether or not stock dividends representing profits may be fairly said to come within the natural, ordinary and logical meaning of the terms "dividends," "profits" and "income" *as applied to shares of stock*, and if so, when? In a recent case in Iowa this question has been answered by adopting the "Pennsylvania" rule, substantially as above set forth. *Kalbach* v. *Clark* (Iowa, 1907) 110 N. W. 599. The theory of these cases is that a dividend of stocks which represent earnings is a distribution of profits, and that, since income from shares is made up from profits which are distributed, these stock dividends are a part of the income and must go to the life tenant. *Earp's Appeal*, supra; *Moss' Appeal* (Pa. 1877) 24 Am. Rep. 164; *McLouth* v. *Hunt* (1897) 154 N. Y. 179. The logical and economic difficulty with this theory is that a distribution of *stocks* is not a distribution of *profits*, since the company's property is not diminished, nor the stockholder's increased by the transaction. There is simply a dilution of the number of shares. *Williams* v. *Western Union Tel. Co.* (1883) 93 N. Y. 162. The very fact that the company issues stock instead of cash would seem to indicate that it has elected to keep the profits for a permanent use instead of distributing them. *Gibbons* v. *Mahon* (1890) 136 U. S. 549; *Spooner* v. *Phillips* (1892) 62 Conn. 62. Nevertheless, the rule has received considerable support. See *Appeal of Philadelphia etc. Trust Co.* (Pa. 1889) 16 Atl. 734; *McLouth* v. *Hunt* (1897) 154 N. Y. 179; *Van Doren* v. *Olden*, supra; *Hite* v. *Hite*, supra; cf. 26 Am. Law Rev. 1.

The theory of the English and Massachusetts cases, on the other hand, is that, since before distribution, the corporation may within its authorized discretion make such use of the earnings as are for the best interests of the corporation, *In re Barton's Trust* (1867) L. R. 5 Eq. 238; 1 Morawetz, Corporations § 447, the election of the corporation to set

aside a portion of the earnings and devote them to the permanent use of the corporation in any form whatsoever converts such earnings into capital. This determination is binding upon the stockholders, and, manifestly, if shares are issued to represent these earnings converted into capital, they are none the less capital, and there is no distribution of income. Hence the action of the corporation, so long as within its authority, must determine whether stock dividends are capital or income. *Bouche* v. *Sproule* (1887) L. R. 12 App. Cas. 385; *In re Barton's Trust*, supra; *Hooper* v. *Rossiter* (1824) 1 M'Clel. 527; *Leland* v. *Hayden* (1869) 102 Mass. 542; *Heard* v. *Eldredge* (1872) 109 Mass. 258; *Rand* v. *Hubbell* (1874) 115 Mass. 461. This doctrine is also well supported, *Gibbons* v. *Mahon* (1890) 136 U. S. 549; *Spooner* v. *Phillips* (1892) 62 Conn. 62; *Greene* v. *Smith* (R. I. 1890) 19 Atl. 1081; *De Koven* v. *Alsop* (1903) 205 Ill. 309; cf. 5 Am. Law Rev. 720; 4 COLUMBIA LAW REVIEW 130, and, it is submitted, offers the more logical and practical working rule. It gives effect to the legal and economic theory of dividends and no complicated investigation into the affairs of the corporation is necessary. See Perry, Trusts, 5th ed., § 545 and note p. 91. Obviously, since the usual object of issuing stock dividends is to retain earnings for permanent use, such dividends will generally be found to be capital and go with the corpus of the trust fund, but it should be observed that this doctrine does not have the effect of laying down an arbitrary rule that all cash dividends are income and all stock dividends capital, for it has been held, under this view, that dividends of cash acquired from the sale of the capital or permanent assets go to the remainderman, *Heard* v. *Eldredge*, supra, and on the other hand that where the corporation bought in its own stock with earnings and divided such stock, such earnings had in no way been set aside as permanent assets, and such stock dividend went to the life tenant. *Leland* v. *Hayden*, supra.

RIGHT OF A CORPORATION TO ACQUIRE ITS OWN STOCK.—England and a few American jurisdictions have denied the right of a corporation, on common law principles in the absence of express authorization, to acquire its own stock, the decisions being based in the main on one or more of three grounds; excess of corporate capacity because of inconsistency with the nature of corporate organization, *Trevor* v. *Whitworth* (1887) 12 App. Cas. 409; *Coppin* v. *Greenlees & Ransom Co.* (1882) 38 Oh. St. 275; Morawetz, Corporations § 112; fraud upon creditors, *Crandall* v. *Lincoln* (1884) 52 Conn. 73; 2 Thompson, Corporations § 2048; and breach of the fundamental agreement between shareholders themselves and also with the State. Cf. *Lowe* v. *Pioneer Threshing Co.* (1895) 70 Fed. 646; Morawetz, Corporations § 112. If the acquisition of its own stock is in excess of the power of a corporation then the doctrine of ultra vires should control all such transactions. The fact is, however, that all American jurisdictions admit the power of a corporation to acquire its own stock in certain cases on the ground of necessity to protect itself from loss, *City Bank of Columbus* v. *Bruce* (1858) 17 N. Y. 507; *State Bank of Ohio* v. *Fox* (1853) 3 Blatchf. 431; Morawetz, Corporations § 114, and this door of necessity has been opened wide enough to include compromises of disputes between stockholders. *Morgan* v. *Lewis* (1888)